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The EU Factor in the Trade Policies of Central European Countries

Bartlomiej Kaminski

Despite strong protectionist sentiments, trade regimes have remained open in Central European countries invited to negotiate their accession to the European Union. Regional disciplines (the EU factor), combined with the legacy of low tariffs under GATT commitments, appear to have offset domestic protectionist impulses.

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Summary findings

Kaminski examines the development of foreign trade institutions and policies in Central European countries invited to negotiate their accession to the European Union.

With the dismantling of state trading, conditions of market access have been dramatically liberalized. However, except for Estonia and, to a lesser extent, the Czech Republic, most Central European countries have followed a policy of bilateral rather than multilateral trade liberalization.

The fall in tariff rates on preferential imports has prompted a search for nontariff barriers, but these countries' trade regimes have remained open — which is surprising, considering the strong protectionist sentiments in economic administration.

Regional disciplines (the EU factor), combined with the legacy of low tariffs under GATT commitments, appear to have been responsible for this openness. Foreign trade policy has been shaped by tensions between domestic protectionist impulses and pressures from the European Union (and other World Trade Organization members) to improve conditions of market access.

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The EU Factor in Trade Policies of Central European Countries */

Bartlomiej Kaminski,
University of Maryland, College Park, and The World Bank

Key terms: foreign trade policy, transition economies, tariffs, non-tariff barriers, regional integration, European Association Agreements

Correspondence: Bartlomiej Kaminski, 3880 University Ave. NW, Washington DC 20016, USA
e-mail: bkaminski@worldbank.org

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1. INTRODUCTION

The paper focuses on three interrelated questions: What are similarities and differences in developments in foreign trade institutions and policies among first-wave candidates (hereafter CE-5) to the EU?[1] Has the contraction in border protection been accompanied by a sudden surge in non-tariff barriers? Why have the national responses of the CE-5 to the fall in tariffs on imports from preferential trading partners varied? Political economy explanations of foreign trade policy do not provide satisfactory answers. They also fail to explain the existing pattern of protection between agriculture and manufacture.

Several common factors have driven liberalization of access to domestic markets of transition economies—both endogenous and exogenous. The most important include the approach to transition as articulated by political elite (endogenous) and imperatives of regional and global WTO-related agreements (exogenous). The former was probably much more significant during the initial phases of the transition, whereas the latter enhanced the commitment to stay the course of economic reforms.

The collapse of central planning has produced two types of responses. The first was an implementation of radical reforms liberalizing large spheres of economic activity with the stroke of a pen. These entailed also liberalization of foreign trade and exchange rate regimes. The second, gradual approach consisted in partial reforms. These actually exacerbated distortions inherited from central planning and produced new ones. Growing macroeconomic disequilibria had subsequently led to the adoption of a radical approach in all transition economies with a few exceptions such as Tajikistan, Turkmenistan and Uzbekistan. All CE-5 economies have followed the radical approach.

Historically, there have been two generally acceptable explanations of foreign trade policy-making (Ray 1988). The first—the micro view—suggests that foreign trade policy mirror the interaction between preferences of interest groups and politicians (see e.g., Grossman and Helpman 1994). The second—the macro view—accords the state considerable autonomy. It stresses national objectives and international commitments as major determinants of international trade policies. The former derive from values shared by political elite: these may range from commitment to free trade, on the one hand, and providing a trade restriction safety net for weak industries, on the other hand. International commitments refer to obligations under regional or multilateral agreements together with mechanisms for adjudicating trade disputes.

None of these views alone provides an explanation of foreign trade policy making in CE-5 economies. First, their major weakness is that they both take institutional arrangements of foreign trade policy-making as given. Institutional arrangements are an important intervening variable between interest groups and policy outcomes. The institutional arrangement determines the extent to which an interest group can highjack the policy (Winters 1995a). This omission is particularly inappropriate in the case of

[1] Thus, the scope of this analysis is limited to the Czech Republic, Estonia, Hungary, Poland and Slovenia.

transition: after all, the transition entails transforming and building institutions. Second, considering the increase in "depth" of international commitments under European Association Agreements (EA), neither the micro approach nor the macro approach alone can provide satisfactory explanations of foreign trade policy dynamics. In other words, foreign trade policy neither mirrors interests of individual constituencies nor can the governments completely ignore these interests.

Trade policy in transition economies has not been an outcome of struggle between pro- and anti-protection forces because the latter have been conspicuously absent in CE-5 policy settings except for Estonia. Initially, the systemic forces driving the shift away from central planning have also driven the developments in foreign trade institutions and policies. If the result of a shift were the setting dominated by rent seeking and accommodating political decision making, foreign trade institutions and policies would embody these characteristics. On the other hand, if the result were an environment friendly to private business development, trade regime would rely on cost-based protection tools. Once, the systemic shock had faded away, it would seem that the scene was set for a standard conflict over protection. However, this has failed to transpire.

The combination of both micro and macro perspectives together with institutional and international dimension offers a good framework to examine factors driving change in foreign trade policy of transition economies. Both domestic and international factors have shaped the transition away from the state monopoly over foreign trade. The international factors determine the scope of choice of policy tools—e.g., tariff versus non-tariff measures. This article argues that the international factors, i.e., the EA, explain to a large extent why some CE-5 economies (especially Hungary and Poland) do not have foreign trade regimes ridden by non-tariff measures and high tariffs. But there are other domestic reasons related to politics of transition from communism as well.

CE-5 countries have already trade regimes based on "... standards and performance norms of advanced industrialized countries" (EBRD 1997, pp.14-15). These two factors alone should make them behave like highly developed economies in terms of foreign trade policymaking. Lower tariff rates should have triggered an increased use of non-tariff measures (NTBs), as the experience of foreign trade policies in highly developed countries in the 1970s and 1980s might suggest. Many analysts, pointing to the growing evidence of a piecemeal protectionism, predicted an increase in the use of NTBs (Drabek, 1996, Messerlin 1995).

But the picture turned out to be more complicated and no clear-cut relationship between falling tariff and increasing NTBs has been observable. First, developments in trade policy have displayed diversity (Michalopoulos 1999). CE-5 cannot be lumped together. Leaving aside Estonia with the best trade regime that of free trade, Hungary and Poland are at the protectionist end of the spectrum. Slovenia lies somewhere between the protectionist end and more liberal Czech Republic whose tariff structure is quite close to that of the EU. Second, flirting with low tariff rates did not last long. With the exception of Estonia, other CE-5 countries have resorted to extra border measures effectively raising the cost of imports also from preferential partners (Drabek 1996). Third, although these measures were phased off by mid-1997 and preferential duties drastically slashed, there was no noticeable increase in NTBs.

Yet, these observations should not lead one to the conclusion that the Czech Republic, Hungary, Poland and Slovenia have conducted sound trade policies. To the contrary, they have put foreign trade policies on a 'wrong' track of bilateral rather than unilateral worldwide nondiscrimination (Messerlin 1995, Winters 1995a). It is important to emphasize that there is nothing wrong with the policy of regional liberalization. To the contrary, the EA and other agreements have imposed external discipline and thus contributed to increased competition in their domestic markets. The point is rather that bilateral liberalization has not spilled over MFN tariff policy. Considering that already most of their industrial imports is duty-free (on average around 60 percent of industrial imports from EU are duty-free) a logical step for CE-5 economies would be to align their MFN to the EU levels. But excluding Estonia (which probably went 'too far' as the EU will have to compensate Estonia's trading partners for deterioration in market access once she joins the EU) and the Czech Republic, other candidates have chosen to maintain significantly higher MFN tariff protection than that in the EU.

The reasons behind sticking to this reverse discrimination are not clear. It would be difficult to blame schizophrenic attitude among policy makers towards liberalization in market access. It may indicate strong bureaucratic resistance to free trade, which cannot resurface vis-à-vis the EU for political reasons (although occasionally it does). But it also points out that there is little intellectual support for free trade. Pro-protection sentiments have dominated policy debates in most of these countries.

The differences among CE-5 economies notwithstanding, this paper argues that tensions between domestic protectionist impulses and the EU's (as well as other WTO members') interest in improving conditions in access to CE-5 markets for its firms have shaped their foreign trade policy. Deprived of external disciplines, protectionism would have prevailed. Ill-designed institutional foundations combined with strong bureaucratic temptation to micromanage trade flows would have created an environment hostile to unilateral liberalization.

The reminder of the paper is structured as follows. Section 2 discusses the shift away from central planning and protective devices used during the initial phases of transition. Section 3 examines emerging patterns of protection in CE-5 countries. The impact of initial conditions at the outset of transition and international agreements on foreign trade policy is discussed in Section 4. Section 5 concludes.

2. FROM STATE TRADING TO REGIONAL LIBERALIZATION

The institutional arrangements underlying central planning effectively separated domestic enterprises from the world economy. They were indifferent to world prices, as they did not bear responsibility for either gains or losses. Because central planning was designed in such a way as to guarantee the permanence of shortages, exports were always a necessary evil to insure indispensable imports. The latter did not compete with domestic supplies—they complemented them. Further, central planners have sought to develop production that would replace imports. In brief, the institutional design of central planning was strongly biased against foreign trade. The purpose of foreign trade reforms under central planning was to lessen anti-trade bias, but they failed to achieve this aim even in the most reformed economies (e.g., Hungary).

State monopoly over foreign trade together with central allocation of convertible currencies and the requirement to surrender hard currency earnings left little room for trade liberalization under central planning until the late 1980s. Importers had to obtain allocation of convertible currencies from the state, or in the case of CMEA suppliers, imports were carried out on the basis of interstate bilateral agreements precisely setting quotas for mutual supplies. Non-tariff measures rather than tariffs determined access to markets. By the same token, tariff concessions made in international agreements (e.g., Hungary's protocol of accession to GATT in 1973) were largely irrelevant. Their trade policies were—as Hillman and Usprung (1996) point out—the converse of trade policies of market economies, which tend to encourage exports and restrict imports.

Thus, since central planning itself was a major non-tariff trade-suppressing barrier, its demise amounted to a huge step towards opening up the economy.[2] Consider that even in reformed Hungary not a single sector was open to competition before 1989. In 1990 around 70 percent of domestic production faced competition.

All first-wave EU candidates moved swiftly to a market-based foreign trade regime following the collapse of the communist rule.[3] Faced with macroeconomic imbalances, former Czechoslovakia, Poland and Estonia dismantled their foreign trade regimes with the stroke of a pen. Poland's stabilization *cum* transformation program introduced current account convertibility of domestic currency and opened almost all sectors of the economy to foreign competition. The objective was to reduce monopolistic hold of large

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[2] For the analysis of trade reforms in other transition economies, see Michalopoulos and Tarr (1994) and Michalopoulos (1999).

[3] The market-based regime entails the dominance of indirect controls operating through modifying incentives of relatively autonomous actors. The institutional component underlying this regime requires decentralization in foreign trade decisions. The state policy influences these decisions through exchange rate policy as well as tariffs and other taxes related to foreign trade activity. Firms respond to various state policy measures because of impact they have on their financial performance. While quantitative restrictions may exist, these are not firm specific. Last but not least, it is mostly devoid of any measures *directly* restricting exports and subsidizing imports.

state-owned enterprises over domestic markets. For a short period of time in 1990, Poland followed the best trade policy, i.e., of free trade. But the subsequent evolution was in another direction (Drabek 1998, Kaminski 1999, and Masserlin 1996).

After a yearlong preparatory work, former Czechoslovakia launched a radical stabilization *cum* transformation program on 1 January 1991. Its major components included a sharp reduction in direct subsidies, an overhaul of the tax system, privatization and the liberalization of prices, foreign trade and exchange rate regimes. In contrast to Poland, however, the increase in border protection (a 20 percent import surcharge) accompanied the launching of the stabilization *cum* transformation program. But following the velvet divorce, the level of tariff protection afforded to domestic firms by the Czech foreign trade regime has declined

Estonia dismantled virtually all export controls in mid-1992 as well as refrained from introducing quantitative import restrictions.[4] More importantly, it has zeroed its tariff rates thus becoming one of a few free trading economies in the world. Although with its application for WTO membership

Hungary entered the post-communist transition with a relatively stabilized economy.[5] In 1989 the government envisaged a gradual liberalization of foreign trade regime in 20-25 percent increments over a four-year period with liberalization of capital goods imports in 1989. With the collapse of the communist regime and the lack of political support for central controls, the process was sped up. In 1990 rationing of imports of intermediate goods was abandoned. So were quotas on a number of consumer goods, albeit very reluctantly and not completely. But in 1995 there was a dramatic reversal in foreign trade liberalization—excluding the effect of nine- percent devaluation, the "effective" rate of aggregate surcharge (excluding tariff rates, if applicable) reached 15 percent (on duty free imports). Under external pressure from the WTO and EU, these measures were gradually phased off.[6]

Slovenia has gradually liberalized access to its markets but unlike Hungary there was no slippage in this process. Former Yugoslavia had neither an open economy nor state monopoly over foreign trade. Its trade regime was similar to an intermediate foreign trade regime. In the 1980s most imports were subject to administrative controls, and domestic markets were additionally protected by high tariffs.[7] Taxes

[4] There was one exception. For fiscal reasons, the Estonian government retained trading monopoly over lucrative metals exports in part to reduce illegal activities (Hansen and Sorsa 1994). Until January 1, 1996, fur and fur products were subject to a uniform tariff rate of 16 percent (Purju 1996).

[5] This was so until 1993 when the current account—after three years of surpluses—swung to a deficit reaching almost 10% of the GDP (Oblath 1997)

[6] Until January 1996, Hungary charged a 6 percent customs fee (3%-statistical fee and 3%-customs clearance fee) which was then reduced to 2 percent. On January 1, 1997, these fees were abolished on imports from WTO-member countries. Thus, the "effective" rate of surcharge on duty-free imports was 15 percent in 1995; 10.75 (until October) and 9.5 percent (November-December, 1996); and 7.5 percent (until March), 5 percent (March-April), and 3.75 percent (May through June 1997).

[7] The average rate of effective protection was estimated at 53 percent in 1986 (Bernard 1997:p. 80).

on exports of raw materials underlined anti-export bias of the Yugoslav foreign trade regime. Large state-owned firms--which in contrast to "socially owned" firms were oriented more towards OECD markets rather than domestic markets--had virtually a monopolistic position, and faced little, if any, competition from domestic or foreign suppliers. Liberalization of foreign trade started before the break up of former Yugoslavia, and by 1990 quantitative restrictions (QRs) covered 22 percent of imports. With a formal recognition of Slovenia's independence by international community in early 1992 and accession to the GATT in 1994, the process of dismantling of vestiges of "market socialism" has accelerated. By 1996 most QRs have been removed--they affected less than 2 percent of Slovenia's imports in 1996. So have been export taxes (World Bank 1998).

The cold-turkey shift from central planning to a market-based foreign trade regime combined with current account convertibility of domestic currency has dramatically liberalized access to domestic markets by removing the state as an intermediary between domestic consumers and foreign suppliers. Except for Estonia, CE-5 countries were members of the GATT before the collapse of central planning. Since then tariffs had no relevance, they often made significant tariff concessions. Low tariffs inherited from central planning further contributed to the erosion of barriers to trade. Estonia moved to a classic free-trade regime. It seems, therefore, that systemic change has been the single most important factor in dramatically reducing protection as compared with central planning.

Another was regional agreements and arrangements, especially those with the EU—the largest trading partner of CE-5 countries. Former Czechoslovakia, Hungary and Poland signed European Association Agreements (EAs) on 16 December 1991. Their trade provisions (implemented on 1 March 1992) largely similar in each EA, froze tariffs on EU imports at then existing levels (standstill principle) and divided industrial imports into three groups. Tariffs were removed for the first group three years into the agreement (1 January 1994); for the second groups after six years (1 January 1997); and for the remaining industrial products duties are removed gradually and will be zeroed on 1 January 2001. Slovenia signed the EA in June 1996, and Estonia in 1995.[8] As a result, around 60 percent of EU exports enter CE-5 (excluding Estonia with 100 percent) markets free of duties and other restrictions.[9]

The proportion of imports entering CE-5 markets is actually higher due to other bilateral agreements exchanging preferential access. They all signed free trade agreements, modeled after the EA, with countries of the European Free Trade Association. The Czech Republic, Hungary, Poland and Slovakia are founding Members of the Central European Free Trade, which entered into force in 1994. Slovenia became its member in 1996, and Romania in 1997. Effective 1 January 1997 almost all duties on

[8] Estonia signed the EA on June 12, 1995. But its trade provisions contained in the Agreements on Free Trade and Trade-Related Matters have been applied since January 1995 (*International Trade Reporter*, Vol. 15, No. 5. 1998, p.202).

[9] As for CE-5 exports, all industrial products enter the EU free of duties and other restrictions.

industrial imports (except some textiles, cars and steel products) were removed. CE-5 countries either have (Estonia) or are negotiating free trade agreements with Latvia and Lithuania. Furthermore, some have signed free trade agreements with Bulgaria, Israel, Croatia (Slovenia) and Turkey. These countries together account for up to 10 percent of CE-5 respective imports.

The consequence of liberalization through bilateral agreements was the increase in reverse discrimination. Although most countries have slashed MFN rates as part of their Uruguay Round commitments, liberalization of tariffs under Europe Agreements, CEFTA, etc. have proceeded at a faster pace.

In all, foreign trade policy responses to the collapse of central planning shared some common features but also considerably varied. The dismantling of state monopoly over foreign trade has dramatically liberalized market access in all CE-5 economies. But then their respective evolutionary paths differed. Estonia has persevered in its unilateral liberalization and free trade policy, while others have opted for regional liberalization as a substitute for universal liberalization. Slovenia has moved along the path of gradualism. Hungary had begun along the same path, but then reversed its policies in 1995, and got back on the track of liberalization in 1997. The Czech Republic stayed the liberal course, and Poland—after a short free trade episode—has resorted to tariff and non-tariff measures.

3. Instruments of Protection

Leaving aside agriculture, one would expect a high dose of similarity in trade policies of the CE-5 for several reasons. They have a shared legacy of central planning; they all adopted a radical approach to dismantle central planning; their geographical pattern of trade with the EU accounting for two-thirds of turnover has become alike; and they all have followed the same pattern of regional free trade agreements. The trade provisions of the EA have stipulated similar pace in tariff reductions on industrial products. Last but not least, under a bit pressure from the European Commission, the CE-5 signed trade liberalizing agreements among themselves thus further extending the scope of industrial product imports either duty-free or still subject to preferential tariffs.

Yet, despite the similarity in external disciplines faced by the CE-5 due to shared trade provisions of the EA and membership in CEFTA (except Estonia), their trade policies have taken different tracks. Some faced with external disequilibria would temporarily circumvent bilateral free trade agreements by resorting to safeguard clauses and import surcharges. In brief, for all of them (except Estonia) falling tariff rates on industrial imports from preferential partners have not spilled over to MFN policy.

On the other hand, however, contrary to what one might expect on the basis of developments in highly developed countries during the 1980s and early 1990s (Baldwin 1993, Daly and Kuwahara 1998), falling tariffs did not seem to lead to the sudden rise in the use of non-tariff measures. There has been, however, a definite movement in that direction even before tariff cuts on imports from the EU began to bite. But not all countries have moved in that direction. And those who have done it at a different pace.

3.1. Tariffs and other temporary measures

With domestic producers increasingly exposed to duty-free import competition from the EU—an economic giant producing a wide array of manufactures competitive in international markets—one would expect the convergence of MFN applied tariff rates on industrial products to those in the EU. With MFN partners accounting for not more then 30 percent of CE-5 respective total imports (a large chunk of which constitute energy and raw materials), one would expect little opposition from domestic producers to regional preferences spilling over to MFN policy. Furthermore, aligning MFN tariff rates on industrial products with those of the EU would have been a logical step leveling off the playing field to MFN suppliers in respective markets.[10]

But none of these has actually occurred. There has been no convergence in MFN tariff policy towards the EU levels. There has been no attempt among CEFTA countries to reduce differences in their MFN rates. Tariff policy towards MFN trading partners has been completely disjointed from bilateral regional liberalization.

Without going into details of each CE-5 MFN tariff structure, it is sufficient to make two general observations. First, there are huge differences in tariff rates within the same product groups among CE-5 (Messerlin 1996). Second, leaving aside Estonia with its duty-free regime, other CE-5 countries have MFN tariff rates on industrial products higher than the EU, albeit lower than most developing countries at a similar level of GDP per capita.

Even with tariff reductions stipulated in the UR Agreements they will remain higher. Table 1 reports MFN applied rates incorporating all tariff reductions agreed at the UR (Uruguay Round). These rates are to be in effect in 1999, although some countries have, for some commodities, negotiated later deadlines. The rates are weighted by world imports of a country excluding imports that receive preferential treatment under free trade arrangements. Finger et al (1996) do not report data for Slovenia.

Except for two product categories (shaded in Table 1) in the case of the Czech Republic and one for Hungary, EU's applied MFN tariff rates are lower. The Czech rates are much closer to the averages for broad product categories than those levied by Hungary and Poland. For the latter two the differences are the largest for transport equipment, non-electric machinery, electric machinery and metals.

[10] Considering future membership in the EU, the best policy option is not that of free trade but that of a full harmonization of MFN rates with those that will be in the EU after the implementation of the Uruguay Round Agreements.

Table 1: Weighted Post-UR MFN applied tariff rates for selected product groups

	Post-UR MFN applied rate (in percent)				*Difference between a partner and the EU*		
Summary product category	**Czech Republic**	**Hungary**	**Poland**	**European Union**	**Czech Republic**	**Hungary**	**Poland**
Wood, Pulp, Paper, And Furniture	4.8	3.3	5.3	0.3	4.5	3.0	5.0
Textiles And Clothing	6.6	8.5	10.4	8.7	-2.1	-0.2	1.7
Leather, Rubber, Footwear	3.4	6.5	8.0	4.9	-1.5	1.6	3.1
Metals	1.9	3.9	5.2	1.0	0.9	2.9	4.2
Chemical And Photographic Supplies	4.1	4.2	7.3	3.8	0.3	0.4	3.5
Transport Equipment	6.9	16.1	10.7	5.5	1.4	10.6	5.2
Non-Electric Machinery	3.3	7.5	6.4	1.4	1.9	6.1	5.0
Electric Machinery	5.4	8.8	9.5	5.4	0.0	3.4	4.1
Mineral Products, Precious Stones & Metal	1.8	2.5	2.2	0.5	1.3	2.0	1.7
Manufactured Articles Nes.	2.5	4.6	5.8	2.5	0.0	2.1	3.3
Industrial Goods	3.7	6.7	6.9	2.9	0.8	3.8	4.0
All Merchandise Trade	3.8	6.8	6.9	2.8	1.0	4.0	4.1

Source: Compiled from Finger, Ingco and Reincke (1996: p. 27, 28, 30 and 37).

However, with more than two-thirds of imports of CE-5 economies coming from preferential partners, the average weighted tariff rate on all imports and consequently the collected tariff rate has been on the decline. The tariff averages alone would put CE-5 economies among a small group of countries with very low tariff rates.

The averages conceal a growing difference between rates applied on imports from preferential partners and on those from MFN partners. For instance, the average preferential tariff rate applied by Hungary on industrial imports was 1.5 percent in 1997, whereas its MFN rate stood at 8.2 percent (Table 2). Table 2 also reports simple averages for Poland's tariffs. While they may not be directly comparable with those for Hungary (different years), they both suggest the existence of very significant levels of reverse discrimination.

Table 2: Hungary's (and Poland's) applied tariff rates, 1997

	MFN	**GSP**	**Average Preferential**	**EU**	**EFTA**	**Poland**	**Czech/ Slovak CU**	**Slovenia**	**Romania**
Simple Average	14.3	5.2	7.1	9.4	9.3	4.4	4.7	8.8	6.0
Agricultural products	37.1	16.6	28.0	37.1	36.3	17.6	18.9	37.1	21.1
Industrial products	8.2	3.4	1.5	2.0	2.0	0.9	0.9	1.2	1.9
Memo: Poland, 1996	**MFN**	**GSP**	**Average Preferential**	**EU**	**EFTA**	**Hungary**	**Czech/ Slovak CU**	**Slovenia**	**Romania**
Simple average	21.3	0.0	4.9	7.5	6.7	3.6	2.0	4.7	N/A

Source: Trade Policy Review: Hungary, WTO, Geneva 1999 and own calculations based on data provided by the Central Statistical Office in Poland.

But, on the other hand, one should bear in mind that around 80 percent of imports are subject to very low tariffs thus making the average collected tariff very low. We have data available only for Poland in 1996. The simple applied average rate was 11.6 percent, whereas the average tariff weighted by 1995 imports was 7.1 percent (Kaminski 1999).

Confronted with appreciating real exchange rates and deteriorating position in current account, some CE-5 countries switched to a crawling exchange rate regime and/or introduced import surcharge. It is interesting to note that while Poland suspended levying tariffs for six months during the first year of its stabilization program, former Czechoslovakia introduced a 20 percent import surcharge just before launching its 1991 stabilization *cum* transformation program (Table 3). Poland levied an import surcharge on all imports between 1993 and 1996 allegedly for balance-of-payments reasons.

Table 3: The use of import surcharge to protect domestic producers, 1990-98

Country	*Import Surcharge*			*Import deposit*		
	Introduced/ revised	Abolished	Magnitude	Introduced	Abolished	Description/comment
Czechoslovakia	12/17/90		20%			
	6/1/91		15%			
	6/1/92	12/31/92	10%			
Czech Republic				4/21/97	8/21/97	20% of invoice price, 6 months, non-interest bearing, applying to 30% of total imports
Estonia	Not applicable			not applicable		
Hungary	3/21/95		8%			Machinery and energy exempt
	7/1/96		7%			
	10/1/96		6%			
	3/1/97		4%			
	5/1/97	7/1/97	3%			
Poland	12/1/92		6%			
	1/1/96	1/1/97	3%			
Slovakia	7/1/96	1/1/97	7.5%			
	8/1/97	1/1/98	7%			
	1/1/98		5%			
Slovenia	Not applicable			Not applicable		

Source: Drabek (1998), *Doing Business in the Czech Republic* (PP Agency, Prague 1997) and various issues of *International Trade Reporter* (published by the Bureau of National Affairs, Inc., Washington, DC).

In Hungary the 1995 stabilization package marked a sharp, though a temporary, departure from the path of gradual liberalization of access to domestic markets that had so far characterized Hungary's transition from goulash communism. It included an extra 8 percent temporary surcharge on imports, except energy and machinery. In addition to the import surcharge, *ad valorem* customs and administrative fees—incompatible with WTO/GATT rules—as well as value-added tax of 25 percent were levied on all imports. Hungary charged a 5 percent *ad valorem* customs fee, which was reduced to 2 percent on 1 January 1996; it was eliminated on imports from WTO-members on 1 January 1997. As a result, the "effective" rate of surcharge was significantly larger reaching its peak level of 15 percent (on duty free imports) in 1995.[11] Adding to that the nine-percent devaluation of the domestic currency, this surge in protectionism over 1995-97 was even larger.

Despite following a similar schedule of tariff concession vis-à-vis preferential partners and the appreciation in effective exchange rates, other CE-5 economies so far have not resorted to import surcharge. The Czech Republic, faced with the foreign exchange crisis in spring of 1997 introduced an import deposit applying to 30 percent of all imports (Drabek 1998), but quickly revoked this measure. This stands in stark contrast to policies pursued by its Customs Union partner—Slovakia, which has levied surcharge since 1996. Neither has Estonia or Slovenia introduced any extra border measures.

While both Hungarian and Polish authorities justified these measures in terms of deteriorating positions in current account; both cases seem to have been the textbook cases of the misuse of commercial policy instruments to increase fiscal revenue. Their timing suggests that the phasing-in of tariff reductions under preferential trading agreements (mainly the EA) did not play a role. Neither has the impulse to introduce this measure come from protection-seeking industries. After all, consider that the major thrust of liberalization in market access due to the EA came in 1997, when import surcharge in both countries was scrapped. Yet, there is no doubt that access to these countries' domestic markets was more restricted than implied by free trade agreements or current tariff rates.

3.2. Non-tariff measures

With the importance of tariffs as instruments of protectionism dramatically falling as the result of post-war trade negotiations under the GATT, the main instruments of protectionism have become non-tariff barriers (NTBs) including quantitative restrictions (Multifibre Agreement products, agricultural products), Voluntary Export Restraints (VERs), licenses and import surveillance. Imports of agricultural products, textiles, footwear and motor vehicles have been frequently subject to such measures. Another group of non-tariff measures—very effective in terms of suppressing imports—relates to the so-called trade remedy laws against "unfair" trade. Anti-dumping investigations and undertakings discourage importers from placing orders for products under investigation as well as for those falling into the same group because of the fear that anti-dumping duties will increase import cost. Some CE-5 governments appear to be doing their best to catch up with the EU, but they still have some way to go.

Table 4 contains data on frequency and import coverage of various NTBs (Non-Tariff Barriers) for Hungary as defined in the UNCTAD database.[12] With the implementation of disciplines contained in

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[11] Until January 1996 Hungary charged a 5 percent customs fee (3%-statistical fee and 2%-customs clearance fee) which was then reduced to 2 percent. On January 1, 1997, these fees were abolished on imports from WTO-member countries. Thus, the "effective" rate of surcharge on duty-free imports was 15 percent in 1995; 10.75 (until October 1996) and 9.5 percent (November-December 1996); and 7.5 percent (until March), 5 percent (March-April), and 3.75 percent (May through June 1997).

WTO Agreements, some of these measures (VER, MFA quotas on textiles, variable levies) either disappeared or will disappear (Daly and Kuwahara 1998).

Table 4: Pervasiveness of NTBs and their coverage in Hungary (percentages)

	Frequency ratio			Import Coverage Ratio		
	1991	1997	U.R.	1991	1997	U.R.
Quantitative restrictions (QRs)	19.9	7.8	3.8	19.5	12.8	8.9
Non-automatic licensing	4.9	2.1	1.9	2.5	4.7	4.6
Other QRs (global quota)	12.2	5.7	1.9	8.5	12.8	8.9
Technical measures	N/A.	3.9	3.9	N/A.	11.4	11.4
All NTBs	19.9	11.7	7.8	19.5	22.4	18.6

Source: Derived from UNCTAD database. See WTO 1998.

While the UNCTAD database does not include all CE-5 economies, it appears that CE-5 countries other than Hungary have relatively low ratios—even well below that of Poland, which amounted in 1996 to 3.2 percent (own calculations).[13] The NTB coverage ratio, that is, the percentage of imports subject to non-tariff measures (i.e., import-weighted frequency ratio) appears to be the highest for Hungary. It amounted to 22.4 percent in 1997 (Table 4). These apply to imports from both preferential and MFN partners. The frequency ratio—indicating the proportion of national tariff lines affected by a NTB no matter whether a particular product is imported—was 11.7 percent.

How do these measures of NTBs pervasiveness in Hungary compare with those in foreign trade regimes of highly developed countries? Daly and Kuwahara (1998) calculated indices for the 'Quad' countries (United States, the EU, Japan and Canada) in 1989, 1993 and after implementation of the Uruguay Round (UR) Agreements. Hungary's all NTBs frequency ratio in 1997 was lower than in the 'Quad' countries in 1993. But its import coverage ratio—a more relevant measure of protectionism—was much higher. US ratio was 8 percent, Canada's was 6 percent, Japan's was 3 percent, and the EU was 11 percent as compared with Hungary's 22 percent.

With the implementation of the UR Agreements, both ratios will decline due to the elimination of quantitative restrictions on agricultural products subject to tariffication and MFA quotas. Hungary's frequency ratio will be larger that the value of this ratio for Canada, Japan and the U.S., but slightly

[12] NTBs—as classified in the UNCTAD Database—include tariff quotas and seasonal tariffs; actions taken to increase tariffs under safeguards or in retaliation; extra customs surcharges; variable levies (including flexible import fees); global quotas; prohibitions or suspension of issuance of licenses; "voluntary" export restraints and products subject to Multifibre Agreements; price control mechanisms (minimum, reference prices; basic import prices and trigger prices); "voluntary" export price restraint; certification and local content requirement; specific taxes levied on imports; health and safety regulations; technical standards; and antidumping and countervailing (undertakings and duties alike). An important problem associated with the analysis of NTBs is that their trade effects or nominal equivalents are very difficult to estimate. See [UNCTAD 1988] for the discussion of problems in the use and interpretation of NTB inventory data.

[13] Note that the NTB coverage ratio does not include technical regulations, which came fully into effect in 1997. Their inclusion would significantly increase this ratio.

smaller than that in the EU (8.2%). As for post-UR import coverage ratio, Hungary's ratio of 19 percent is several times higher than that in Canada (3%), Japan (3%), the EU (4%) or the United States (2%).

While the NTB coverage ratio is quite high by the standards of 'Quad' countries, types of measures used are much less diversified. Hungary relies mainly on quantitative restrictions in form of discretionary (non-automatic) licensing and quotas. These two account for around 60 percent of NTB-affected imports. Other 'Quad' countries resort to variable charges (which replaced variable levies), antidumping and countervailing. The latter are especially popular in the US, where they replaced VERs, especially for steel products (Daly and Kuwahara 1998).

3.1.1. Quantitative restrictions (QRs)

Except for Hungary and Poland, no other CE-5 country maintains significant quantitative restrictions on imports of industrial products. In terms of measures identified in the UNCTAD database Poland relies mainly on quantitative restrictions with 84 percent of NTB-affected imports controlled by quotas and prohibitions. The NTB-ridden groups in Polish imports are beverage and tobacco, live animals for meat, and motor vehicles (Table 5). NTBs on agricultural products testify to political power of the agricultural lobby, whereas those on cars illustrate the misuse of trade policies as a way to attract FDI. In 1995 these sectors accounted for 83 percent of all imports affected by NTBs. Almost all other sectors--even those with a significant share of state-owned enterprises are relatively free of NTBs.

Table 5: Pervasiveness of Polish NTBs and their coverage by major product groups in 1995

	NTB Coverage ratio	Frequency ratio	Value of Imports affected by NTBs	Value of Imports	Share of the EU in Imports	Share of the EU in NTB-Affected Imports
	(in %)	(in %)	(US$ million)	(US$ million)	(in %)	(in %)
All Products (1 to 8)	3.21	1.60	928	28,902	64.8	82.3
All Products excluding fuels (1 to 8-3)	3.53	1.61	926	26,237	69.1	82.5
Foods (0+1+22+4)	4.90	12.79	136	2,776	46.8	74.3
Live Animals (0)	3.36	8.72	78	2,334	46.3	84.6
Beverages and Tobacco (1)	26.56	58.33	58	217	41.5	84.6
Manufactures (5 to 8-67-68)	3.82	0.82	790	20,669	74.9	83.9
Chemicals (5)	0.49	0.18	21	4,298	69.1	2.4
Motor vehicles (781)	99.97	98.44	466	466	87.3	87.3
Other manufactures	2.32	0.50	303	13,074	75.5	84.5

Source: own calculations based on Central Statistical Office foreign trade data and the UNCTAD database on NTBs.

However, the major culprits are automobiles accounting for more than 50 percent of NTB-affected imports. Interestingly, foreign investors have largely contributed to it by linking their decision to invest to increased protection of domestic markets. Under pressure from General Motors, Poland raised its tariffs on imported new cars from 15 to 35 percent in 1991.[14] However, since such an increase in tariffs conflicted with the Europe Agreement, Poland introduced a duty free quota of 30,000 cars originating in the EU. Although the quota was to be operated on a first-come, first-served basis, the Polish authorities heeding the advice from Fiat and General Motors sought to link its allotments in favor of firms that have already made commitment to invest in Poland. General Motors sought 40 percent of the duty free quota for its German division—Opel. Because of European Commission's protests (apparently lobbied by other large producers of cars with no investment in Poland), the Polish authorities eventually abandoned their scheme to lure investors through the duty-free quota. The irony is that General Motors decided then not to go ahead with the project, while non-tariff measures have spilled over to other areas of Poland's trade regime for cars and automotive parts producing significant distortions in allocation of resources for the years to come.

Hungary resorts to two types of quantitative restrictions; one is a uniquely Hungarian *global quota on consumer goods*; and another entails import licensing. The list of products subject to global quota remains quite extensive, albeit beginning in 1998 its coverage slightly declined (Table 6). In 1991, the quota was set at US$ 630 million, and subsequently raised to US $750 million. With the removal of all agricultural products as a result of tarification required by the Uruguay Round Agreements, its value fell to US$ 518 million in 1995, but rose again in both 1996 and 1997.

Table 6: Hungary's Global Quota on Consumer Goods, 1995-98 (in million of US dollars unless specified otherwise)

	1995	1996	1997	1998 (projected)
Household detergent	25	35	45	50
Footwear	65	70	39	85
Overwear 1/	94	104	114	22
Secondhand clothing	27	29	32	removed
Other clothing 1/	65	71	78	12
Haberdashery products	17	17	23	5
Carpets 1/	43	47	26	3
Other manufactured goods	126	133	146	161
Jewelry, precious metal objects	33	34	38	41
Fish, canned fish	23	23	33	27
Used cars and vans (in thousand of units)	53	55	59	63
New cars and vans (in thousand of units) 2/	81	84	90	68
TOTAL	518	563	574	406

Notes: 1/ removed for imports from WTO member countries; 2/ apply only to cars with engine above 1, 500 cc.
Source: Ministry of Trade, Industry and Tourism

The value of the global consumer quota declined in 1998. One item--second hand clothing--was removed from the global quota. So were textile and clothing products but only on imports from WTO-

[14] *The Financial Times* (March 9, 1992) suggests that this increase was a condition for beginning negotiations on an investment by General Motors.

member countries. Used cars are subject to an extra restriction—imports of vehicles more than four years are prohibited under the Customs Duty Law of 1995 on environmental and safety grounds.[15] Thus, quotas on these products, substantially reduced in terms of value in comparison with 1997, apply only to imports from non-WTO countries, that is, mainly from former Soviet republics (excluding the Baltic States and Kyrgyz Republic—the latter since late 1998 due to WTO-accession).

It is noteworthy that these liberalizing changes have been introduced not because of domestic commitment to liberal foreign trade policies. The changes were rather driven by international obligations. The EA required that Hungary remove QRs on imports of several categories of products including automobiles (with engines larger than 1,500 cc), baby food, transmitter and reception devices, etc. The EA as well as other free trade agreements with EFTA, Turkey and Israel obligated Hungary to remove QRs on a whole range of textile and clothing products by 31 December 1997.

The global quota strikes one as an anachronism—a vestige of central planning. Its existence dates back to Hungary's protocol of accession to the GATT in 1973. As a Hungarian economist notes "... the global quota is the last remaining openly discretionary and outright protectionist element in Hungarian foreign trade régime." (Csaba 1996: 16). While under central planning this tool had little, if any, relevance, its significance as a barrier to trade had rather drastically increased with the full abolition of state monopoly over foreign trade.

Moreover, it seems to be a redundant instrument with little purpose. In some cases, one may explain QRs in terms of the political economy of protectionism. This is likely the case of cars, where the desire to attract foreign direct investment during the early stages of the transition had often overridden purely economic considerations. But maintaining quotas on jewelry or canned fish cannot be so easily explained. It only testifies to perseverance of micromanagement of foreign trade—legacy of central planning.

3.1.2. Licenses

Leaving aside arms, weapons, substances threatening public safety or products subject to special restrictions in importing countries, CE-5 do not seem to use licenses as a way to curb imports. Except for Hungary, which has a complex system covering both exports and imports other CE-5 have rather standard procedures granting general licenses.

On the export side, the Hungarian list contains "harmless" agricultural products, some metal ores, gold and silver. Among agricultural products goose and duck livers are subject to internal quotas imposed externally by the EU. But it does not appear to be the case of other products such as durum wheat, barley

[15] As the authors of the WTO report note, "...such a prohibition combined with high tariffs on imports [...] and the global quota on new and relatively new cars tends to curtail competition" and "... is likely to reduce the pace of replacement of old cars, which are usually more polluting and embody lower safety standards then new or relatively new cars." (WTO 1998b, p. 47).

(removed on 1 July 1998) or sugar beet (removed on 1 July 1998).[16] Overall, around 6 percent of exports were subject to non-automatic license requirement in 1998.[17]

The list of products subject to non-automatic licensing is much more extensive on the import side, although it directly affects a smaller percentage of imports.[18] The list contains fish and fish products, some chemicals, textiles and clothing (the longest list in terms of tariff items), some wood products, footwear, precious metals, vehicles, and arms. Protection of domestic producers or national security considerations (arms trade) does not appear to be the only reason for maintaining licensing. For instance, caviar is not domestically produced. In addition, there is a "common" list, that is, a list of tariff items subject to licensing in both export and import activities. It contains energy resources (coal, oil and natural gas); precious metal ores and their products as well as products described as hazardous to environment and/or public health.

Last but not least, there is a list of products subject to non-automatic licensing both for exports and imports. It contains the following groups of products: energy (coal and coal sorts; and crude oil and natural gas); precious metals and articles (silver, gold, and jewelry); and environmentally and health hazardous materials.

In all, while some products seem to be justifiably subject to control, others do not. Their presence indicates merely a bureaucratic temptation to micromanage. The danger inherent in this type of arrangement is that they provide opportunities for rent-seeking activities.

3.1.3. Technical standards

Because technical standards—technical regulations and certification systems—can increase unit costs of production, they often emerge as a barrier to international trade. Many governments use technical standards as a tool to restrict market access. Since Article 75 of the EA requires that CE-5 harmonize their technical and certification systems with those in the EU, one would expect that they refrain from resorting to technical barriers to trade.

Indeed, they all have made significant progress in improving compatibility with EU technical regulations and standards. Their technical regulations are mostly worded in terms of performance rather than product design; conformity assessment procedures are applied on a nondiscriminatory basis; and most CE-5 recognize accreditation issued by international standardizing bodies as a proof of meeting adequate technical regulations. The common task remains closing gaps between national standards and international

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[16] The Ministry of Agriculture decides on a list of products to be licensed for exports. Although wheat was taken off the list in 1997, exporters have to make a deposit of FT 500 per ton.

[17] *Newsletter*, Ministry of Foreign Trade, Industry and Tourism, Budapest, Vol. 10, No. 1, 1998, p.2.

[18] Ibidem.

or EU standards. In a nutshell, the process has been driven by the desire to become a full-fledged member of the EU Single Market rather than offering extra protection to domestic producers.

There are, however, some exceptions in terms of either using national standards or not accepting foreign certificates. For instance, according to the European Commission, the Czech government increased in 1997 the coverage of products subject to special tests conducted by the State Testing Laboratory. For these products test results of an independent foreign standardizing body are not recognized.[19]

Poland seems to have erected a much more significant barrier to trade by imposing its own rules covering initially over 1,400 product categories.[20] Products listed in the Certification Law, which require domestic testing, account for a large percentage of all products consumed and produced in Poland. The Law covers steel products, nonferrous products, capital equipment, precision products, transport equipment, electronic products, engineering products, chemicals, construction materials, glass and ceramic products, wood and paper products, textiles and clothing, and leather products.

The Certification Law has introduced a formidable non-tariff barrier to trade, as these products account for a very large share Poland's manufactures imports. According to these regulations, which came fully into effect on January 1, 1997,[21] safety certificates issued by foreign governments are no longer recognized. The refusal to accept foreign firms' self-certification of conformance to domestic standards forces producers from other countries to undertake lengthy testing procedures in designated units. This has created problems not only for foreign companies but also for Polish exporters, as governments in EU countries do not recognize Polish safety certificates. This requires further testing and often at considerable cost. While a firm can appeal negative test results especially for products meeting international standards, procedures adopted lack transparency (USTR 1996: 291). Potential losses associated with the decline in contestability of domestic markets and negative impact on foreign investors' assessment of business climate would be difficult to assess, but are likely to be significant.

It is not immediately apparent what considerations prompted the authorities to introduce this Law. The official rationale--protecting the consumer--does not strike one as very convincing. It seems that its benefits in terms of protecting consumers against "dangerous" products are minimal. Furthermore, while the Law has put up a significant barrier to imports, as products identified in it account for a very large share of Poland's manufactures imports, it does not provide protection to selective sectors of the economy.

[19] Yet, the Czech Republic appears to have resisted the temptation of following the policies of its customs union partner—Slovakia. In a move that took Czech exporters by surprise, the Slovak government introduced in September 1997 a requirement that imported products must obtain a technical certification subject to specific regulations and Slovak special technical norms (Besik 1998).

[20] The coverage was eventually reduced by half for exporters from the EU (*International Trade Reporter*, March 19, 1997: 520).

[21] Due to pressures from major trading partners (including CEFTA), the full implementation of the law was delayed two times before it came into effect in 1997. In early 1997 Poland and the EU initialed an agreement on the mutual recognition of safety certificates which will eliminate duplicative safety certification procedures. While its signing had been originally linked with Poland's adopting product liability laws, it was put into effect in late 1997.

The only clear beneficiaries are old branch institutes—the vestige of the Soviet model of research and development. With their designation as the only units to perform tests for a fee, the law seems to have saved them from extinction, but at the price of reducing competition from imports.

3.3. Institutional design: policy implications

The importance of a good institutional design for foreign trade lies in its long term impact on policy making; give a country "... the institutions to make sound policy and you affect it for a decade" (Winters 1995a, p.1). In other words, a sound economic policy may quickly evaporate unless accompanied by the right institutions containing bad policies. The ultimate test of a sound institutional design for foreign trade is the extent to which it insulates the decision making process against capture by narrow interest groups. Foreign trade decisions are classic collective action problems with a huge asymmetry in incentives between beneficiaries and losers (Olson 1965). Gains from foreign trade liberalization spread across wide segments of society, whereas losses affect only inefficient producers from import-competing sectors. Since losses are concentrated and gains dispersed, the potential losers have a much stronger incentive to organize in order to block the measure.

How can then the influence of losers be counterbalanced? While there is no single right way of designing trade policy institutions, two general guidelines should be followed to keep import competing firms and other organized interests at arms' length from the policy formulation and implementation process--centralization and openness. Assigning policy responsibility to high levels of authority and encouraging participation of a wide range of interests in the process usually reduce the possibility of a capture.

In more specific terms, trade economists seem to have converged on a series of rules-of-thumb to design a good policy regime. These include among others. First, the legislature--the natural locus for tax-policy making in democracy--should focus only on broad trade policy issues, whereas a detailed trade policy should be responsibility of the executive branch.[22] Second, the executive must explicitly assume responsibility for all the policy consequences. Third, within the executive, officials from sectoral ministries should not be involved in trade policy making. Last, industries using imports should have the right to participate in foreign trade policy decision-making and administrative protection procedures should provide for "... the explicit seeking and recognition of consumer and user-industry views, public hearings and the explicit quantification of the costs and benefits of protectionist measures." (Winters 1995b, p.37).

[22] Otherwise, the risk of capture and protectionism increases dramatically. The way to prevent narrow interests from having too large influence is the use of committees and of rules to reduce amendments from the floor (see Winters 1995b, p. 21-26).

Estonia, as Purju (1996) convincingly shows, is the only CEE-5 economy meeting fully these institutional requirements. The institutional design of foreign trade policy formation in other CE-5 suffers from several shortcomings. Although reforms of central government have tended to 'centralize' foreign trade policy setting, they located the locus of foreign trade policy making in a wrong place. Prior to the reform of central government the location of foreign trade policy was within its own ministry rather than together with industry. Subsequently, however, they became integrated in a single ministry in the Czech Republic, Hungary and Poland. As a result, trade functions are now performed jointly with other industrial functions of a new ministry.

From the point of view of trade liberalization this integration of functions amounts to asking a fox to guard a hen house. Consider that industrial bureaucracies are set to defend domestic industries at any price. The danger implicit in this institutional arrangement is that protecting domestic industries will prevail over liberalization.

The problem of capture by private interests is further compounded by two errors of omission. First, the Ministry of Agriculture remains involved in foreign trade policy-making. Protection of farmers rather than of consumers is the mandate of this Ministry in any country, not only in CE-5. While agricultural import regimes are less protectionist than in the EU, there have been several cases suggesting that narrow agricultural interests often capture foreign trade policy.

Second, the reforms have not "opened" the trade policy-making process. The present framework does not offer an adequate framework to balance the interests of import-competing industries against those of other producers and consumers. Sectors using imports are not encouraged to participate in foreign trade policy decision-making. There are no provisions that would provide for taking into account consumer and user-industry views; that would require public hearings over contemplated trade policy measures; and that would call for the explicit quantification of the costs and benefits of these measures.

Although under these institutional settings the danger of protectionist interests capturing the foreign trade policy making process cannot be easily discarded, it would be difficult to point to any instances. Consider first that foreign trade policies in CE-5 countries that introduced these administrative reforms did not become more protectionist as a result of it. Neither technical barriers nor a single quantitative restriction can be directly attributed to these institutional arrangements.

Second, although all CE-5 economies have introduced anti-dumping legislation, they have not used this tool to curb imports from WTO-member countries. It appears that the demand for anti-dumping or countervailing was not significant. For instance in Hungary, since 1994 there have been only two requests for anti-dumping actions against WTO suppliers, which were rejected (WTO 1998b). The Czech Republic has not resorted to anti-dumping or countervailing duty actions. Neither has it taken any safeguard actions. Poland has taken several safeguard actions, but under the EA.[23] Since the full-fledged legislation on antidumping was in effect (December 1997), no antidumping action has been reported. It may be that domestic producers are able to find protection by other means. Import licensing and quotas would be a possibility in most CE-5 economies.

3.4. Power of agricultural lobby

The exception is agriculture. Agricultural lobby has captured trade policy in most CE-5 countries. Agricultural commodities, together with prepared food, beverages and tobacco are the broad product categories of products, most protected by tariffs. Just before the tarification provisions of the WTO Agreement on Agriculture went into effect, some countries introduced variable import levies. This was the case of the Czech Republic in 1992. Its Customs Union partner—Slovakia—followed suite. Poland—with its trade policy influenced by farmers represented then in Government by the Peasant Party—introduced in 1994 variable import levies on eight groups of agricultural products (Drabek 1998). With or without presence in a government coalition, the agricultural lobby had a considerable say in Poland's foreign trade policy—consider for instance that all antidumping cases (although quickly dropped) initiated in Poland in 1991 concerned agricultural products.

With the implementation of the WTO Agreement on Agriculture in 1995, non-tariff measures were converted into tariffs. The average tariff rates on agricultural products rose in all countries. For instance, Hungarian average tariff rate rose from around 24 percent to 45 percent, and Romania's average weighted tariff rate increased from 25 percent to 75 percent.

Trade in agriculture remains the source of frequent conflicts in relations among CEE-5 countries as well as between them and the EU. New tariffs and other restrictions frequently emerge against imports from both the EU and other CE-5 countries. However, if interests of EU exporters are at stake, the European Commission usually finds ways to influence trade decisions in CE-5. Considering that that the EU applies preferential margins and offers duty preferences to agricultural imports originating in CE-5 (WTO 1998a, p. 25), this should come as no surprise.

Anderson (1994), using a stylized model, shows that the increase in protection of agriculture is more likely in rich countries as this will have a marginal effect on the purchasing power of the urban population, thus reducing incentive to lobbying effort. By this measure, the CE-5 would qualify as rich countries, which clearly they are not. Alternatively one should look for an explanation in the ways that

[23] Although Poland initiated 25 antidumping investigations over 1987-97 (Miranda, Torres and Ruiz 1998), 24 of them were initiated in 1991 and one in 1997. Of 24 cases initiated in 1991, 12 of them concerned animal products (mainly beef from EU-member countries) and 12 fats and oil (from EU-member countries, Bulgaria and Belarus). They were all quickly terminated for the lack of compelling evidence (Skoczny, 1995). An investigation initiated in 1997 concerned 'other manufactures' and was not completed in 1997 (Miranda et al. 1998). Their legal base was the Counteracting Monopolistic Practices Act, which contains a provision prohibiting predatory pricing practices defined as "... selling below costs of production of production to eliminate competitors" (Art. 5, sec. 1, para. 5).

political system has evolved there with the corresponding strength of the agricultural lobby and Ministry of Agriculture. In addition, one should note apparent publics support to pro-agriculture measures as demonstrated, for instance, by overall a favorable public attitude towards peasants' protest in the fall of 1998 in Poland.

In contrast to industrial products, regional agreements do not seem to provide strong checks on policies affecting access to markets for agricultural products. The argument that the EU is more protectionist in its agricultural policies than CE-5 tends to be used to justify the introduction of trade restricting measures.

3.5. Bureaucratic temptation: micromanaging tariffs

A unique feature of foreign trade policies, which can be easily explained in terms of the legacy of central planning, is excessive temptation of economic bureaucracies to create opportunities for micromanagement. The foreign trade regime that has emerged in CE-5 economies seems to be designed in ways offering quite a few opportunities for *ad hoc* management. These opportunities relate to tariff suspensions, exemptions and/or tariff quotas. Tariff systems of CE-5 countries (excluding Estonia) provide for the use of tariff relief measures on MFN basis.

The process of managing tariff exemptions and quotas lacks transparency and is devoid of clearly defined criteria for granting tariff exemptions. The process infuses an extra dose of uncertainty and increases the risk of being captured by rent-seeking private interest. Take Poland for instance: Tariff suspensions or quotas cover a wide range of products—in 1996 around 4,000 Common Nomenclature categories. It seems that frequently political rather than economic considerations drove the choice of products (Kaminski 1999). These embraced the following: responding to emergency input needs of some industrial sectors undergoing restructuring; responding to pressures exerted by foreign investors; 'remedying' the alleged deficiencies in the existing tariff structure; and subsidizing central government agencies and local governments (as some tariff suspensions have been only available to them).

Since these are not non-tariff barriers in a strict sense, it would seem that they only improve market access and increase competition. But this is not so. Leaving aside standard distortions they introduce through tariff escalation, etc., the potential welfare losses due to increased uncertainty in business activity and increased dependence of many firms on state's pork barreling while difficult to capture quantitatively are quite significant. Their use creates an environment inducing favors and rent seeking activity, which can easily spill over other areas of foreign trade policy. Firms are encouraged to look for favors from the economic administration instead of focusing on improving competitiveness of their products.

The potentially most damaging impact of quotas and tariff exemptions for transition economies is that it impedes the transformation in the role of the state from that of an owner and operator to that of a policy maker and facilitator of private economic activity. Another danger inherent in this type of arrangement is that by providing opportunities for rent-seeking activities they unnecessarily mud political atmosphere. Last but not least, it offers the administration a proven way to regain some of its discretional power lost as a result of the collapse of central planning.

3.6. Assessment

No clear-cut pattern emerges from this review of the five first-wave EU entrants. Leaving aside a clear preference for integrating into the EU, there is no single clear-cut pattern in developments of their foreign trade institutions and policies. But—again leaving out Estonia—there are at least some common traits. The prospect of accession seems to have tipped the balance in favor of regionalism and bilateral rather than multilateral liberalization in their trade policies. Bilateral free trade agreements, including the CEFTA, were a response to the vision of the European Commission of establishing a single trading bloc in Europe.

Yet, there has been a significant degree of variation in terms of both tariff policy vis-à-vis MFN partners and the use of NTBs. As for MFN tariffs, there was no decisive attempt to break away with those inherited from central planning. It appears that Czech MFN tariffs are low because they were low on the eve of the 'Velvet Revolution'. Hungarian and Polish tariffs were higher before the collapse of central planning, and they still remain higher than in the Czech Republic. Slovenia inherited Yugoslav MFN tariffs, quite significantly reduced over 1987-90, and also made no attempt to overhaul them. The exception is again Estonia.

Although over 1992-96 tariff reductions envisaged in EAs had little or no impact on domestic producers, the use of import surcharges occurred in that period. It is even more revealing that countries with lower tariffs, that is, the Czech Republic, Estonia and Slovenia have not resorted to this measure of curbing imports. Thus it seems that balance-of-payments considerations prompted these actions.

Three founders of CEFTA have established foreign trade institutions (with the exception of Estonia and Slovenia) offering extra opportunity for shopping for protection. This has not so far resulted in the increase in the use of NTBs, however. Nonetheless the danger is that under economic duress these arrangements make a foreign trade regime vulnerable to pressures for protection.

Another common trend is importance assigned to designing and implementing legislation on antidumping and countervailing. Again a remarkably feature is that this exercise has been entirely futile as no CE-5 country has resorted to antidumping or countervailing against WTO-member countries.

Under these circumstances, the absence of actions designed to increase the level of protection runs counter to what one might expect. Consider also that by January 1, 1997, CE-5 economies removed tariffs on most industrial imports from the EU while the so-called sensitive products are subject to tariffs well below MFN levels. Consider also that on average almost three-thirds of EU exports enter CE-5 economies free of duties or other restrictions. This has clearly increased competition from imports. Thus, one would thus expect strong pressures from domestic producers to obtain extra protection as well as positive response from democratically elected politicians.

Since WTO commitments and these undertaken under the EA have removed tariffs from the realm of current politics, they could only respond by resorting to NTBs. But despite the fall in applied tariffs due to regional and multilateral WTO commitments, there was no surge in the use of non-tariff measures. Even the measures that were either maintained or introduced in relatively protectionist Hungary or Poland strike one as irritants rather than huge barriers to trade. So are those recently introduced in the Czech Republic, which turned to administrative pressures to force retailers display more prominently Czech-made products. It also passed the lottery law banning foreign firms to organize contests for consumers and grant promotional awards, but under the pressure from the European Commission this Law is to be eliminated in 1999.

4. Factors Accounting for Peculiarities of CE-5 Trade Policies

The absence of the surge in protectionism defies predictions one could infer from the experience of other countries. Despite some occasional slippage, the CE-5 countries have stayed the liberal course. They have done so despite the apparent lack of political support for free trade among elite and populace at large. It would be tempting to argue that import-competing industries were not able to organize and lobby effectively for protection. But then why have farmers been so effective in their efforts to increase protection? It seems that the answer to this riddle can be found in unique conditions associated with the experience of central planning and the EU factor.

4.1. Initial conditions and trade policy

Two factors stand out among initial conditions. First, the inherited levels of tariffs were relatively low with the exception of Slovenia. Since the state monopoly over foreign trade rather than tariffs shaped imports of centrally planned economies, CMEA GATT members—the Czech Republic as a GATT founding member in particular—had relatively low tariffs. Raising them would send a wrong policy message in defiance of transition. In consequence, there was little political support for raising tariffs.

Second, dismantling of administrative micromanagement of foreign trade and liberalization of exchange rate regime were integral components of the stabilization-cum-transformation package in each CE-5. The termination of central planning in foreign trade was an enormous step in opening the economy to foreign competition. Huge depreciations accompanied the unification of exchange rates and introduction of current account convertibility of domestic currencies.

Leaving aside the state of political flux triggered by the demise of central planning, the "big bangs" in former Czechoslovakia, Poland as well as in Estonia were accompanied by a significant depreciation in the real exchange rates. The extent of undervaluation of the domestic currency can be to some extent captured by ratio of the nominal market exchange rate to the PPP (purchasing power parity) rate.[24] Following Balcerowicz and Gelb (1994), a ratio exceeding two may be regarded as indicating an undervaluation of the domestic currency for middle-income developing countries. By this measure, except for Hungary and Slovenia, domestic currencies were either undervalued or close to the "normal" level (Table 7).

Before proceeding any further one caveat needs to be made. The PPP-exchange rate measure does not seem always to adequately mirror developments in external sector. Although initially—despite an appreciation—returns to exporting tended to be high and imports were kept at bay, the change in PPP-exchange rate ratio fails to explain the variation in their performance. Consider three cases—those of the Czech Republic, Hungary and Slovenia. Considering that the Czech GDP per capita is significantly higher than in Hungary and Poland, the values of PPP-exchange rate ratios above two did not indicate the exchange rate being out of equilibrium. But this was of course the case in 1996-97. The appreciation of the real exchange rate of the Czech koruna vis-à-vis its pegged currencies, German mark and US dollar, triggered a foreign exchange crisis in 1997.[25] Similarly puzzling is the case of Hungary, which experienced a foreign exchange crisis over 1993-94. The nine-percent devaluation of the Hungarian forint in 1995 had little impact on the PPP-exchange rate ratio.

Table 7: Ratio of PPP-exchange rates to nominal exchange rate, 1990-97

	1990	1991	1992	1993	1994	1995	1996	1997
Czech Republic	3.06	3.42	3.08	2.78	2.54	2.14	2.04	2.24
Hungary	1.80	1.88	1.98	1.82	1.56	1.50	1.55	1.65
Poland	3.54	2.12	1.92	2.05	2.09	1.76	1.69	1.83
Slovenia	1.06	1.36	1.38	1.45	1.38	1.11	1.17	1.28
Memorandum:								
Bulgaria	0.68	4.36	4.07	3.29	3.65	2.82	3.52	3.13
Romania	2.64	2.87	4.11	3.19	2.98	2.72	2.91	2.76

[24] Nominal and PPP exchange rates diverge even for highly developed market economies. The difference tends to grow for countries with lower GDP per capita. One would expect that a currency of a poorer country would tend to be more undervalued in terms of nominal exchange/ PPP ratios.

[25] The Czech Republic maintained a fixed exchange rate until May 27, 1997. Imports exploded in 1995-96, while exports stagnated leading to a huge current account deficit. The high interests rate differential between domestic and international rates combined with expectations that the koruna exchange rate would continue appreciating attracted foreign investment. It also led to heavy borrowing abroad by banks and enterprises further exacerbating external sector disequilibrium. Thus, the combination of an overvalued domestic currency and high interest rates was responsible for the crisis.

Source: own calculations derived from data in Kaminski, Wang and Winters (1996), UN ECE *Economic Survey of Europe* (various annual publications) and Podkaminer et al. 1998.

These observations may provide extra ammunition to Drabek's and Brada's (1998) warning that "... the evidence regarding the validity of PPP as a standard of equilibrium in the external balance shows that deviations of actual exchange rates from PPP-based rates are more the exception than the rule." There is no evidence, however, that the introduction of import surcharges by Hungary and Poland was in response to domestic pressures from import-competing industries, although these measures might have deterred protectionist pressures.

One can only speculate as to other domestic factors. It appears that the state has retained significant autonomy vis-à-vis other domestic actors including firms. Despite remarkable progress achieved in establishing foundations for competitive markets and changing the overall role of the state in the economy, a strong asymmetry in state-private sector still remains. One suspects this has suppressed some voices for protection.

Radical liberalization in conditions of market access did not seem to be a shared value of political elite of new emerging democracies in CE-5 economies. Except for Estonia and the Czech Republic, no other transition economy has seriously contemplated pursuing the course of unilateral trade liberalization. Poland adopted a classic free-trade policy, but only for a period of six months in 1990.[26] Two years into the transition the dominant rhetoric was that of an alleged excessive and harmful liberalization during the initial phases of the transition (Csaba 1996). Since there have been no major reversals, an interesting question is about the impact of regional agreements on the process of trade liberalization.

4.2. How restraining are Europe Agreements?

Regional agreements, organized around the EA, have shaped foreign trade policies of CE-5 countries. The EA have been responsible for a whole web of other agreements—taken together they envisage establishing a single European free trading area for industrial products by 2001. All other agreements including and those with EFTA countries were driven and modeled after the EA. The EFTA countries signed the preferential trade agreements usually within a year after the EAs were signed. The preferential trade agreement with EFTA (European Free Trade Association) in 1992, modeled after the

[26] Despite the suspension of tariffs, the policy makers could not resist temptation of ad hoc management as exemplified by the imposition of extra taxes on imported consumer electronic products (Rosati 1991).

EA, was followed by CEFTA (Central European Free Agreement), which entered into force in 1993.[27] CEFTA was set up under pressure from the EU and EFTA countries.[28]

The EA has had a significant impact on tariffs, although the EA allow for temporary "exits" (see below). First, the EA initially "froze" tariff rates of CE-5 imports from the EU by adopting the standstill principle. Once the Interim Trade Provisions of the EA went into effect neither new duties nor any other charges with similar effects could be implemented. Average MFN tariff rates have thus become significantly higher than rates levied on imports from the EU and other preferential partners.

Second, the EA provided for the establishment of bilateral free-trade areas within a period of ten years (2001). With the entry into force of the Pan-European Cumulation Agreement on July 1, 1997, CE-5 countries became part of a single trading bloc. In addition to the EU and CE-5 economies, this trading block encompasses also EFTA, Switzerland, Bulgaria, Latvia, Lithuania, Romania and Slovakia. The Agreement, adopting schedules of tariff reductions of the EA, puts an end "... to the partition of Europe into several regional trading zone in the early 1990s" (Nell 1996:131). By the year 2001 all tariff barriers on manufactures will be removed.

The EA impact on the use of NTBs is less clear. The EA, which is very specific on tariff measures, does not embrace any special provisions that would limit the use of NTBs. Although the EA stipulates the elimination of tariffs and quantitative restrictions on industrial imports, it also provides provisions allowing withdrawal from obligations under the EA to safeguard (protect) specified interests. The EA does not ban the use of non-tariff measures under specified circumstances. CE-5 countries and the EU alike can resort to any of eight safeguard clauses contained in the EA. Two of these can be employed under explicit conditions and six are specific to particular groups of products or circumstances regarded by EA signatories as unique to an economy in transition from central planning. Since the safeguard clauses are non-transparent, softly disciplined and loosely defined, they are "... open to virtually unconstrained administrative discretion."(Ostry 1993, p.14).

Signatories may resort to various import-limiting measures subject to GATT rules,[29] albeit somewhat weakened. The EA provides weaker disciplines on the use of safeguard measures than those of the GATT do. The CE-5 governments can use the so-called restructuring clause without proving injury to

[27] The Central European Free Trade Agreement (CEFTA) signed in 1992, provides a framework for bilateral agreements among six states: the Czech Republic, Hungary, Poland, Slovakia, Slovenia (which acceded in 1996) and Romania (which acceded in July 1997). More precisely, the CEFTA system has two components: a multilateral and bilateral. A multilateral component comprises commonly agreed preferences, whereas a bilateral one those negotiated bilaterally and not extended to all CEFTA members.

[28] The apparent motives were twofold--to boost intra-regional trade after the collapse of the CMEA, and to reduce regional tariffs towards EU levels.

[29] These may include anti-dumping, protection against balance of payments disturbances, protective measures against disruptions in markets for agricultural products covered by the EA, as well as other bans and restrictions.

domestic producers. Poland, for instance, has frequently resorted to this clause to raise tariffs.[30] Other CE-5 have been more reluctant.

Turning back to the question in the title of this section, few observations can be made. First,the focus of the EA's trade component is on preventing negative externalities rather than on compelling CE-5 governments to adopt policies that would increase national welfare. The EA trade component aims mainly at areas affecting market access and trade between CE-5 countries and the EU. Its provisions are too limited to assure emergence of a good trade regime, which would tame special interests of politicians and import competing sectors (a litmus test for the quality of foreign trade institutions and policies). The EA has safeguard provisions allowing for a temporary suspension of disciplines. Hence, they cannot be fully relied upon to reduce the use of NTBs.

Second, it would seem that strong domestic political support for integration into the European Union has weakened and restrained protectionist temptation. But the prospect of integration was not a sufficient condition. A much more important factor was commitment of political elite to break decisively with vestiges of central planning. The absence of this commitment was conducive to reluctance to open up the economy.

One may thus conclude that both commitment to radical economic reforms and accession to the EU shaped foreign trade institutions and policies of CE-5 economies. The two have reinforced each other. The process of economic integration into the EU has served as a basis for domestic transition in CE-5 countries towards a market based economy. The protectionist impulses of economic bureaucracies in many CE-5 countries seem to have been contained by the imperative of accession, albeit not always and not fully.

CONCLUSION

The picture that emerges from this review of trade policies pursued by first-wave candidates for EU accession with the notable exception of Estonia escapes simple explanations. Consider the following two apparent paradoxes. First, while in view of the EAs the best tariff policy action is by all means an alignment of MFN applied duties on industrial products with the EU post-UR rates, not a single country has chosen to follow this path. Considering that around 70 percent of their industrial imports are already free of tariffs, it would be difficult to find a logical economic explanation for an apparent resistance to improve market access for non-preferential suppliers. Domestic producers have been already exposed to

[30] Restructuring clause was used to justify the increases in tariffs (not to exceed the respective MFN applied rate and up to a three-year period) on imports of telecommunication equipment (since 1994), of petroleum products (in 1996 raised from 12 to 15%), oil (raised to 25% in 1996), and trucks, trailers, special vehicles and bodies chassis (tariff rates raised from 30 to 35 percent). In the cases discussed above no injury to domestic producers as an explanation to adopted measures had to be demonstrated. These derogations from trade liberalization envisaged in the agreements were not part of a comprehensive program of restructuring because there was none. Rather they resulted from pressures either to protect domestic producers or to attract foreign investors.

strong international competition from EU firms. The reduction in MFN applied tariff rates would probably add little in terms of competitive pressure.

Second, despite establishing institutions encouraging protectionism, the rapid fall in tariffs on imports from preferential partners has not led to the emergence of strong domestic pressures for the use of non-tariff measures. Most CE-5 have reformed central administration in ways increasing the scope for shopping for protection by domestic producers. CE-5 have also adopted WTO-consistent antidumping legislation, yet not a single antidumping measure against a WTO-member has been implemented. Leaving aside pressures coming from agriculture and foreign investors in automobile manufacturing, most discussed non-tariff measures seem to have originated with economic bureaucracy rather than domestic producers.

The combination of pro-protection sentiment commanding the mindset of political elite and bureaucracy in CE-5 economies (except Estonia) with the requirements associated with integration into the EU seems to explain unique features of trade policies. The two have been pushing in opposite directions, with the latter prevailing because of political commitment to integration into the EU. Despite its many safeguards, the EA has been used as a shield for either introducing or rejecting policy measures.

CE-5 have been (and probably still are) in transition. It seems that for this reason developments in their trade institutions and policies defy predictions that might be derived from the political economy models. The main source of pro-protection actions appears to have been bureaucracy not necessarily acting under the pressure from domestic producers. Although pro-free trade lobbies remain conspicuously absent in politics of the CE-5 (except Estonia), the combination of self-interested pressure from the European Commission and CE-5 government commitment to overall liberalization seems to have prevented resurgence of protectionism.

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